

1996

Shareholder's Instructions for Schedule K-1 (Form N-35)

Shareholder's Share of Income, Credits, Deductions, etc.

(For Shareholder's Use Only)

(Section references are to the Internal Revenue Code, unless otherwise noted.)

General Instructions

Basis in Corporate Stock. You are responsible for maintaining records to show the computation of your basis in stock of the corporation. Schedule K-1 provides you with information to help you make the computation at the end of each corporation tax year.

The initial basis of a resident shareholder in the stock of an S corporation and in any indebtedness of the corporation owed to the shareholder shall be determined in the manner provided under the Internal Revenue Code. The initial basis shall be determined as of the last to occur of the following:

1. The shareholder last became a resident of Hawaii;
2. The shareholder acquired the stock or the indebtedness of the corporation; or
3. The corporation became an S corporation.

The initial basis of a resident shareholder in the stock and indebtedness of an S corporation shall be adjusted after the above date in the manner and to the extent required by section 1011 except that, with respect to any taxable period during which the shareholder was a resident of Hawaii, any modification made (other than for income exempt from federal or State taxation) to the shareholder's income from the S corporation shall be taken into account; and any adjustments made pursuant to section 1367 for a taxable period during which Hawaii did not measure S corporation shareholder income by reference to the corporation's income shall not be taken into account. The basis of a resident shareholder in the stock of an S corporation shall be reduced by the amount allowed as a loss or deduction, not to exceed the combined adjusted basis of the shareholder in the stock and indebtedness of the corporation.

The initial basis of a nonresident shareholder in the stock of an S corporation and in any indebtedness of the corporation to the shareholder shall be zero. The initial basis shall be determined as of the last to occur of the following:

1. The shareholder acquired the stock or indebtedness of the corporation;
2. The corporation became an S corporation; or
3. The shareholder last became a nonresident of Hawaii.

The initial basis of a nonresident shareholder in the stock and indebtedness of an S corporation shall be adjusted after the above date in the manner provided in section 1367, except that adjustments to basis shall be limited to the income attributable to Hawaii and taxable to the nonresident shareholder for Hawaii income tax purposes. In computing income attributable to Hawaii, any modification made for income exempt from federal or Hawaii taxation shall be taken into account.

Shareholders who are not Hawaii residents will be asked by the S corporation to complete and sign an agreement (Schedule NS) stating that the shareholder agrees to file a Hawaii net income tax return, make timely payments of taxes due, and to be subject to personal jurisdiction in the State of Hawaii for purposes of the collection of unpaid income tax. Shareholders for whom an agreement is not obtained and filed by the S corporation on its timely filed return are subject to withholding by the S corporation of 10% of the shareholder's income

attributed to Hawaii. This amount, shown on line 12h, may be claimed as a credit on a nonresident Hawaii net income tax return (Form N-15) subsequently filed by the shareholder or may take the place of filing a Hawaii return by the nonresident shareholder. **No credit will be allowed for this amount until the S corporation has filed and paid the amount due.** Shareholders for whom an agreement is obtained and filed as required may be included in a composite net income tax return filed on behalf of an S corporation's nonresident shareholders.

Errors. — If you believe the corporation has made an error on your Schedule K-1, notify the corporation and ask for a corrected Schedule K-1. Do not change any items on your copy. Be sure that the corporation sends a copy of the corrected Schedule K-1 to the Department of Taxation.

Specific Instructions

Name, Address, and Identifying Number. — Your name, address, and identifying number, the corporation's name, address, and identifying number, and items A and B should have been entered. If the corporation is involved in a tax shelter, item C will be completed. The corporation completes item D, if applicable.

Lines 1 through 21

If you are an individual shareholder, take the amounts shown in columns (b) and/or (c) and enter them on the appropriate worksheet and/or lines of your tax return. If you are an estate or trust, report the amounts shown in columns (b) and/or (c) as instructed on Form N-40, Hawaii Fiduciary Income Tax Return.

The amounts on lines 1 through 21 show your pro rata share of ordinary income, loss, deductions, credits, and other information from all corporate activities. These amounts do not take into account limitations on losses or other items that may have to be adjusted because of your adjusted basis in stock and debt in the corporation, the at-risk limitations under section 465, the passive activity limitations of section 469, or any other limitations that must be taken into account at the shareholder level in figuring taxable income (e.g., the section 179 expense limitation). These limitations are discussed in the instructions for federal Schedule K-1 (Form 1120S).

Note: The line number references in column (d) are to forms/worksheets in use for tax years beginning in 1996. If you are a calendar year shareholder in a fiscal year 1996-1997 corporation, enter these amounts on the corresponding lines of the tax form in use for 1997.

Caution: If you have losses, deductions, credits, etc., from a prior year that were not deductible or useable because of certain limitations, such as the at-risk rules, they may be taken into account in determining your income, loss, etc., for this year. However, do not combine the prior year amounts with any amounts shown on this Schedule K-1 to get a net figure to report on your return. Instead, report the amounts on your return on a year-by-year basis.

Shareholders who are residents of Hawaii report the total of columns (b) and (c) for each item. Shareholders who are nonresidents of Hawaii, report only the amounts in column (b). If you are an individual shareholder and your share of pro rata

items are affected by any limitations, adjust the amounts before you enter the amounts on your return.

Form N-11 filers, most of your pro rata share of ordinary income, loss, deductions, etc. are included in Federal Adjusted Gross Income (federal AGI). If the total of the amounts in columns (b) and (c) of your Hawaii Schedule K-1 (Form N-35) and the amounts in your federal Schedule K-1 (Form 1120S) are different, make the necessary adjustments in the Hawaii Additions Worksheet and/or Hawaii Subtractions Worksheet of the Form N-11 instructions.

Line-by-line Instructions

Income

Line 1. Ordinary income (loss) from trade or business activities.—The amount reported on line 1 is your share of the ordinary income (loss) from trade or business activities of the corporation. Generally, where you report the amount depends on whether the amount is from an activity that is a passive activity to you. Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) for the amount to report. Include amount on Form N-12, line 18 or on Form N-15, line 20.

Line 2. Net income (loss) from rental real estate activities.—Generally, the income (loss) reported on line 2 is a passive activity amount for all shareholders. If there are exceptions, then refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S). Include the amount on Form N-12, line 16b or on Form N-15, line 17.

Line 3. Net income (loss) from other rental activities.—The amount on line 3 is a passive activity amount for all shareholders. Report a loss following the instructions for federal Form 8582. Report income on Form N-12, line 16b or on Form N-15, line 17.

Line 4. Portfolio income (loss).—Income or loss referred to as "portfolio" income or loss is not part of a passive activity subject to the rules of section 469. Portfolio income includes income not derived in the ordinary course of a trade or business from interest, dividends, annuities, or royalties, and gain or loss on the sale of property that produces these types of income or is held for investment.

Line 4a. Interest.—Include the amount in the Interest Worksheet in the Form N-12 instructions or on Schedule B (Form N-15), Part I, line 2.

Line 4b. Dividends.—Include the amount in the Dividend Worksheet in the Form N-12 instructions or on Schedule B (Form N-15), Part II, line 4.

Line 4c. Royalties.—Include the amount on Form N-12, line 18 or on Form N-15, line 20.

Line 4d. Net short-term capital gain (loss).—Include the amount in the Capital Gain/Loss Worksheet in the Form N-12 instructions or on Schedule D (Form N-15), line 5.

Line 4e. Net long-term capital gain (loss).—Include the amount in the Capital Gain/Loss Worksheet in the Form N-12 instructions or on Schedule D (Form N-15), line 13.

Line 4f. Other portfolio income (loss).—Line 4f is used to report income other than that reported on lines 4a through 4e. The type and the amount of income reported on line 4f will be listed in the line 22 Supplemental information space of Schedule K-1. Include the amount on the applicable line of your return. An example of the type of income reported on line 4f is income from a real estate

mortgage investment conduit (REMIC) in which the corporation is a residual interest holder. Report your share of the REMIC income on Form N-12, line 16b or on Form N-15, line 17.

Line 5. Net gain (loss) under IRC section 1231 (other than due to casualty or theft).—Section 1231 gain or loss is reported on line 5. The corporation will identify the activity to which the section 1231 gain (loss) relates in line 22 Supplemental information space of Schedule K-1. If the amount on line 5 is from a rental activity, the section 1231 gain (loss) is a passive activity amount. Likewise, if the amount relates to a trade or business activity and you did not materially participate in the activity, the section 1231 gain (loss) is a passive activity amount. Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) for applicable amount to report. Include the applicable gain or loss on Schedule D-1, line 2.

Line 6. Other income (loss).—Amounts on line 6 are other items of income, gain, or loss not included on lines 1 through 5. The corporation should give you a description and the amount of your share for each of these items. Include the amount of income (loss) on the applicable line of your return. Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) for more information.

Deductions

Line 7. Charitable contributions.—The corporation will give you a schedule that shows the amount of contributions subject to the 50%, 30%, and 20% limitations. Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) for the amount to report. Include amount in the Worksheet A-4 - Gifts to Charity in the Form N-11 instructions for Form N-12 filers or on Schedule A (Form N-15), line 13 or 14.

Line 8. IRC section 179 expense deduction.—Include this amount along with the total cost of section 179 property placed in service during the year from other sources, to complete federal Form 4562, Depreciation and Amortization. If the amount is allocable to a passive activity from the corporation report the amount following the instructions for federal Form 8582. If the amount is not a passive activity deduction, include it on Form N-12, line 16b or on Form N-15, line 17.

Line 9. Deductions related to portfolio income (loss).—Amounts on line 9 are the expenses (other than investment interest expense and section 212 expenses from a REMIC) paid or incurred to produce portfolio income. Generally, include the amounts in the Worksheet A-6 Miscellaneous Deductions in the Form N-11 instructions for Form N-12 filers or on Schedule A (Form N-15), line 20a. These deductions are not taken into account in figuring your passive activity loss for the year.

Line 10. Other deductions.—Amounts on line 10 are other deductions not included on lines 7, 8, and 9. The corporation should give you a description and your share of each of the expense items. Include the amount of deduction on the applicable line of your return. Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) for more information.

Investment Interest

If the corporation paid or accrued interest on debts properly allocable to investment property, the amount of interest you are allowed to deduct may be limited. For more information and the special provisions that apply to investment interest expense, see Form N-158, Investment Interest Expense Deduction, and federal Publication 550, Investment Income and Expenses.

Line 11a. Interest expense on investment debts.—Include the amount on Form 158 along with your investment interest expense from other sources to determine how much of your total investment interest is deductible.

Lines 11b(1) and (2). Investment income and investment expenses—Use the amounts on these

lines to determine the amount to enter on line 1 of Form N-158.

Caution: *The amounts shown on lines 11b(1) and 11b(2) include only investment income and expenses reported on lines 4a, 4b, 4c, 4f, and 9 of this Schedule K-1. If applicable, the corporation will have listed in the line 22 Supplemental information space any other items of investment income and expenses reported elsewhere on this Schedule K-1. Be sure to take these amounts into account, along with the amounts on lines 11b(1) and 11b(2) and your investment income and expenses from other sources when figuring the amount to enter on line 1 of form N-158.*

Credits

Any S corporation doing business in Hawaii may qualify for Hawaii's Capital Goods Excise Tax Credit, the Credit for Employment of Vocational Rehabilitation Referrals, or the Enterprise Zone Tax Credit. Hawaii S corporations may also qualify for the Fuel Tax Credit for Commercial Fishers, the Credit for Energy Conservation, and the Low-Income Housing Tax Credit.

All filers, except as noted in Credits for Nonresidents later, should complete the appropriate forms to claim their pro rata share of credits.

Line 12a. Fuel Tax Credit for Commercial Fishers.—There should be attached to this Schedule K-1 a copy of Form N-163A substantiating the amount of your share of the credit. If the form is not attached, contact your corporation as you will need to attach a copy of the form to the Hawaii net income tax return you file in order to receive the credit. Figure your credit on Form N-163.

Line 12b. Total cost of qualifying property for the Capital Goods Excise Tax Credit.—There should be attached to this Schedule K-1 a copy of Form N-312A showing your share of the total cost of qualifying property to be used to claim the credit. If the form is not attached, contact your corporation as you will need to attach a copy of the form to the Hawaii net income tax return you file in order to receive the credit. Figure your credit on Form N-312.

Line 12c. Credit for Energy Conservation.—There should be attached to this Schedule K-1 a copy of Form N-157A substantiating the amount of your share of the credit. If the form is not attached, contact your corporation as you will need to attach a copy of the form to the Hawaii net income tax return you file in order to receive the credit. Figure your credit on Form N-157.

Line 12d. Amounts needed to claim the Enterprise Zone Tax Credit.—There should be attached to this Schedule K-1 a copy of Form N-756A showing your share of the corporation's amounts needed to claim the credit. If the form is not attached, contact your corporation as you will need to attach a copy of the form to the Hawaii net income tax return you file in order to receive the credit. Figure your credit on Form N-756.

Line 12e. Hawaii Low-Income Housing Tax Credit.—Hawaii's low-income housing tax credit is equal to 30% of the federal credit for qualified buildings located in the State of Hawaii. The federal credit must be claimed in order to claim the Hawaii credit. Attach Form N-586, Tax Credit for Low-Income Housing, to your return.

Line 12f. Credit for Employment of Vocational Rehabilitation Referrals.—Your share of the credit is shown on this line. Refer to Form N-884 for further information.

Line 12g. Credit for Hawaii income tax withheld on Form N-288.—If there is an amount on line 12g, include this amount on Form N-12, line 56 or on Form N-15, line 44g and attach a copy of this Schedule K-1 to your N-12 or N-15.

Line 12h. Credit for Hawaii income tax withheld on Form N-4 (Nonresident shareholders only).—If there is an amount on line 12h, include this amount on Form N-12, line 46 or on Form N-15, line 44b.

Line 12i. Pro rata share of net income tax paid (Resident shareholders only).—A resident shareholder shall be considered to have paid a tax imposed on the shareholder in an amount equal to the shareholder's pro rata share of any net income tax paid by the S Corporation to a state which does not measure the income of S corporation shareholders by the income of the S corporation. Include amount in Other State and Foreign Tax Credit Worksheet in the Form N-11 instructions or Other State and Foreign Tax Credit Worksheet in the Form N-12 instructions.

Credits for Nonresidents — If you are a nonresident of Hawaii and are filing a Form N-15, Individual Income Tax Return Nonresident, and there is an amount or amounts on line 12c, 12e, or 12f, enter the sum of these credits on Form N-15, line 41. If there is an amount on Schedule K-1, line 12e, for the Hawaii Low-Income Housing Tax Credit, you may apply this credit only after all other credits have been applied against your Hawaii income tax liability. Part II of Form N-586 is to be completed as follows. Enter your tax liability from line 39, Form N-15 on line 8. On line 9, enter the total of lines 40 and 41 without the Hawaii Low-Income Housing Credit, and 44e through 44g from your Form N-15. Include the amount on line 11 of Form N-586 on line 41, Form N-15.

If there is an amount on Schedule K-1, line 12a, Fuel Tax Credit for Commercial Fishers, the amount that is entered on Form N-163, line 8 is to be included on Form N-15, line 44g.

Other

Form N-11 filers, if there are differences between your Hawaii Schedule K-1 (N-35) and your federal Schedule K-1 (1120S), make the necessary adjustments in the appropriate worksheet in the Form N-11 instructions (if applicable).

Line 13. Property distributions.—Reduce the basis of your stock in the corporation by the distributions on line 20. If these distributions exceed the basis of your stock, the excess is treated as gain from the sale or exchange of property and is reported in the Capital Gain/Loss Worksheet in the Form N-12 instructions or on Form N-15 Schedule D.

Line 14. Tax exempt interest income.—Generally, you must increase the basis of your stock in the corporation by the amount shown.

Line 15. Other tax exempt income.—Generally, you must increase the basis of your stock in the corporation by the amount shown.

Line 16. Nondeductible expenses.—The nondeductible expenses paid or incurred by the corporation are not deductible on your tax return. Generally, you must decrease the basis of your stock in the corporation by this amount.

Line 17. Amount of loan repayments for "Loans from Shareholders".—If the line 17 payments are made on indebtedness with a reduced basis, the repayments result in income to you to the extent the repayments are more than the adjusted basis of the loan.

Lines 18. Adjustments.—Report your pro rata share of adjustments as applicable.

Line 19. Interest penalty on early withdrawal of savings.—The amount of line 19 is included on line h of the Hawaii Subtractions Worksheet of the N-11 instructions and attach an explanation or on Form N-12, line 25.

Recapture of Tax Credits

Line 20. Recapture of Hawaii Low-Income Housing Tax Credit.—Report your pro rata share of recapture of the Hawaii Low-Income Housing Tax Credit from section 42(j)(5) partnerships and other sources. Complete Form N-586.

Line 21. Capital Goods Excise Tax Credit Properties.—You should receive a completed copy of Form N-312A from the corporation. Use this information to determine the amount of credit recapture on Form N-312.

SHAREHOLDER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

1996

For calendar year 1996 or tax year

beginning _____, 1996 and ending _____, 19____

(NOTE: Prepare in triplicate. (1) File with N-35. (2) For S corp. (3) For shareholder.)

Shareholder's identifying number ➤

Shareholder's name, address, and ZIP code

Corporation's Federal identifying number (FEIN) ➤

Corporation's name, address, and ZIP code

A (1) Shareholder's percentage of stock ownership for tax year ➤ _____ % and (2) Number of shares owned by shareholder at tax year end ➤ _____
(See Instructions for Schedule K-1)

B Taxation District Office where corporation filed its return ➤ _____

C Federal tax shelter registration number _____ ➤

D Check applicable boxes: (1) ☐ Final K-1 (2) ☐ Amended K-1

Caution: Refer to Shareholder's Instructions for Schedule K-1 before entering information from Schedule K-1 on your tax return.

(a) Pro rata share items		(b) Attributable to Hawaii	(c) Attributable Elsewhere	(d) Enter on Form N-11 * or	
				i. Form N-12**	ii. Form N-15
Income (Losses)	1 Ordinary income (loss) from trade or business activities.			Line 18	Line 20
	2 Net income (loss) from rental real estate activities.			Line 16b	Line 17
	3 Net income (loss) from other rental activities.			Line 16b	Line 17
	4 Portfolio income (loss):				
	a Interest.			Interest Worksheet (WS)	Sch. B, Part I, line 2
	b Dividends.			Dividend WS	Sch. B, Part II, line 4
	c Royalties.			Line 18	Line 20
	d Net short-term capital gain (loss).			Capital Gain/Loss WS	Sch. D, line 5
	e Net long-term capital gain (loss).			Capital Gain/Loss WS	Sch. D, line 13
	f Other portfolio income (loss) (attach schedule).			(Enter on applicable line of your return)	
Deductions	5 Net gain (loss) under IRC section 1231 (other than due to casualty or theft) .			Schedule D-1, line 2	
	6 Other income (loss) (attach schedule).			(Enter on applicable line of your return)	
	7 Charitable contributions.			WS A-4	Sch A, line 13 or 14
	8 IRC section 179 expense deduction (attach schedule).			Line 18	Line 20
Investment Interest	9 Deductions related to portfolio income (loss) (attach schedule).			WS A-6	Sch. A, line 20a
	10 Other deductions (attach schedule).			(Enter on applicable line of your return)	
	11 a Interest expense on investment debts.			Form N-158, line 1	
	b (1) Investment income included on lines 4a, 4b, 4c and 4f above.			} See Shareholder's Instructions.	
	(2) Investment expense included on line 9 above.				

* For Form N-11 filers, if your federal schedule K-1 (Form 1120S) and Hawaii schedule K-1 (Form N-35) are different, the necessary adjustments are to be made in the Hawaii Additions Worksheet and/or Hawaii Subtractions Worksheet in the Form N-11 instructions.

**For Form N-12 filers, the referenced worksheets are located in the Forms N-11 and N-12 instructions.

Purpose of Schedule K-1 — The S corporation uses Schedule K-1 (Form N-35) to report to you your share of the corporation's income (reduced by any tax the corporation paid on the income), credits, deductions etc. Please keep it for your records.

Although the corporation is subject to a built-in gains tax and an excess net passive income tax, you, the shareholder, are liable for the income tax on your share of the corporation's income, whether or not distributed, and you must include your share on your tax return.

You should use these instructions to help you report the items shown on Schedule K-1 on your Hawaii income tax return. Where "(attach schedule)" appears next to lines 6, 8, 9, 10, and 18, it means the information for these lines (if applicable) will be shown on line 22, or if additional space was needed, the corporation will have attached a state-

ment to your Schedule K-1 to show the information for the line item. The notation "(See Instructions for Schedule K-1)" in item A is directed to the corporation. As a shareholder, you should ignore this notation.

Schedule K-1 does not show the amount of actual dividend distributions the corporation paid to you. The corporation must report to you such amounts on Form 1099-DIV. Resident shareholders' actual dividend distributions are already included in Federal Adjusted Gross Income (Federal AGI) for Form N-11 filers or are to be reported in the Dividend Worksheet in the Form N-12 instructions for Form N-12 filers.

Schedule K-1 now provides you with information relating to the source of your share of the income of the S corporation. This is required under provisions of Act 16, SLH 1990. How this income is reported by you to the State of Hawaii depends on your residency status. Shareholders who are Ha-

waii residents are to report the total sum of the income, deductions, and credits attributable to Hawaii and the income, deductions, and credits attributable elsewhere. Shareholders who are not residents of Hawaii for tax purposes are to report only the income, deductions, and credits attributable to Hawaii. Income attributable to Hawaii is reported by all shareholders net of adjustments allowed to corporations. The total of your share of these adjustments is shown on line 18 and are explained on line 22. Items of income or deductions should be reported on your return net of these adjustments. Resident shareholders may make an adjustment to income reported on their net income tax return for interest penalty on early withdrawal of savings, if a penalty was imposed on the early withdrawal of savings by the S corporation and the interest income is not attributable to Hawaii. The amount of this deduction appears on line 19.

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